

United States House of
Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

March 13, 2020

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Chairman McWilliams,

I am writing regarding the Federal Deposit Insurance Corporation's (FDIC) recent notice that it will be meeting on Tuesday, March 17, at 2:00 p.m., and one of the agenda items for discussion is a "Notice of Proposed Rulemaking, Parent Companies of Industrial Banks and Industrial Loan Companies."¹ As I and other Financial Services Committee Members wrote you the other day,² this meeting comes at a critical time for our country as we confront the global spread of the coronavirus disease 2019 (COVID-19), including at least 1,629 confirmed cases and 41 deaths in the United States.³ To date, the coronavirus has spread across 46 states and the District of Columbia.⁴ I look forward to your response to our letter regarding this urgent crisis.

Regarding your potential meeting, I previously wrote the FDIC requesting a public hearing on a previous application by one company to obtain federal insurance for a state-chartered industrial loan company (ILC).⁵ The company later withdrew its application, but the issues identified in my letter also apply to pending ILC applications before the FDIC, including concerns with regulatory oversight of ILCs generally, the need for strong consumer protection and reinvestment, and the importance of preserving the separation of banking and commerce.⁶ Furthermore, it has been more

¹ FDIC, *Sunshine Act Meeting* (Mar. 11, 2020).

² Committee Press Release, *Waters Leads Letters Calling on Regulators and Financial Institutions to Protect Americans and the Financial System from Impact of Coronavirus* (Mar. 11, 2020).

³ Center for Disease Control and Prevention (CDC), *Coronavirus Disease 2019 (COVID-19) in the U.S.*, last updated Mar. 13, 2020.

⁴ *Id.*

⁵ See Committee Press Release, *Waters Calls on FDIC to Hold Public Hearing on SoFi's Application for Bank Charter* (Aug. 25, 2017).

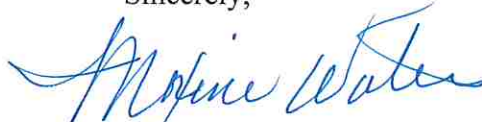
⁶ Many of these concerns have been highlighted by community banks, community groups, government agencies, and other stakeholders and experts, both in general and in response to recent ILC applications. For example, see Board of Governors of the Federal Reserve System, FDIC and the Office of the Comptroller of the Currency, *Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act*, (Sep. 2016), page 28; Government Accountability Office, *Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions* (Jan. 19, 2012); Independent Community Bankers Association, *Industrial Loan Companies: Closing the Loophole to Avert Consumer and Systemic Harm*

than a decade since the FDIC approved federal insurance for an ILC application, so it is imperative that the FDIC proceed cautiously before setting a new precedent that may be difficult to reverse. Additionally, there is bipartisan interest and proposals from several Members in Congress to address some of the shortcomings in the current ILC regulatory framework that may be addressed in part by your agency's new regulatory proposal.⁷

Therefore, to the extent the FDIC issues a proposal for public comment that will change the rules for ILCs and their parent companies as soon as next week, I would encourage the FDIC not to approve any new ILC application until after the agency receives and considers feedback on the new regulatory proposal from experts, stakeholders, and Congress and finalizes any new rules.

Thank you for considering this request as well as the concerns and perspectives that a wide range of stakeholders have provided to your agency on the ILC applications pending before the agency. I look forward to your response.

Sincerely,



MAXINE WATERS
Chairwoman

Enclosures

(Mar. 2019); National Community Reinvestment Coalition, [NCRC Comment Letter On Rakuten Charter Application](#) (Aug. 30, 2019); American Bankers Association and Bank Policy Institute, [ABA-BPI Joint Comment Letter Opposing Rakuten ILC Application](#) (Aug. 30, 2019); and Americans for Financial Reform, [Comment Letter Regarding SoFi](#) (Jul. 19, 2017). See attachments for related materials.

⁷ For example, see Politico, [Garcia bills would derail tech's financial ambitions](#) (Nov. 12, 2019), Rep. Chuy Garcia's Discussion Draft of "[Close the ILC Loophole Act](#)" considered at Committee hearing entitled, "[Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions?](#)" (Dec. 4, 2019); and Press Release, [Sen. John Kennedy Files Legislation To Protect Consumers And Community Banks](#) (Nov. 13, 2019).

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

August 25, 2017

The Honorable Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Gruenberg,

I am writing to request that the Federal Deposit Insurance Corporation (“FDIC”) hold at least one public hearing on Social Finance, Incorporated’s (“SoFi”) application to establish an industrial loan company (“ILC”) to provide FDIC-insured Negotiable Order of Withdrawal (“NOW”) accounts and credit card products. As you know, because *de novo* ILC formations have been affected by regulatory and statutory moratoria for several years, the FDIC has not approved a deposit insurance application for a new ILC charter for some time. Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), changes in the financial regulatory regime and financial services industry justify a public hearing to examine the policy and legal implications of granting Federal deposit insurance to ILCs generally, as well as to obtain greater input on the unique risks posed by granting it to a financial technology (“fintech”) company like SoFi, a number of which I will discuss in more detail below.

In addition, the small number of comment letters submitted on SoFi’s application, despite the high level of past public and congressional opposition to the ILC applications submitted by Walmart and Home Depot, calls into question whether there is adequate public awareness about this pending application and, by extension, also strengthens the case for why a public hearing on SoFi’s application is needed. Notwithstanding the fact that the short time period for public comment on SoFi’s application has expired, I believe that the FDIC’s decision on this application should be conducted in the most deliberative, transparent manner possible and, in order to do so, a public hearing is needed. While FDIC regulations appear to leave the determination of whether to hold a public hearing to the discretion of the regional director, I urge you to exercise your authority as Chairman to require that a public hearing be held on this ILC application to ensure that all external stakeholders and members of the public have adequate opportunity and time to provide input on this landmark application.

I. Concerns with regulatory oversight of ILCs generally and concerns with allowing fintech companies to be approved as federally-insured ILCs

Appropriate regulatory oversight of any ILC is an essential prerequisite to approving any application for deposit insurance backed by taxpayers. The FDIC has previously acknowledged the importance of strong oversight of any insured bank and its parent company when discussing oversight of ILCs.¹ In reaction to a number of concerns previously raised on the regulation of

¹ See Mindy West, FDIC Senior Examination Specialist, *The FDIC’s Supervision of Industrial Loan Companies: A Historical Perspective* (June 2004), https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html (“Monitoring

ILCs, the FDIC even went so far as imposing several moratoria on its ability to approve ILC applications for deposit insurance in 2006 and 2007 to, in the words of former FDIC Chairman Sheila Bair in testimony before the House Financial Services Committee, “allow the FDIC to carefully weigh the safety and soundness concerns that have been raised regarding commercially-owned ILCs. At the same time... the moratorium provides an opportunity for Congress to consider the important public policy issues regarding the ownership of ILCs by commercial companies.”²

In 2007, the U.S. House of Representatives passed H.R. 698, the Industrial Bank Holding Company Act of 2007,³ which would have enhanced the regulation of the parent companies of industrial banks, restored the traditional separation between banking and commerce, prevented branch banking by some commercially-owned ILCs, prohibited the FDIC from granting new charters to commercial companies seeking to start or acquire ILCs, and bolstered the examination and enforcement authorities of the FDIC as an ILC regulator. The bipartisan bill was sponsored by former Reps. Paul Gilmor (R-OH) and Barney Frank (D-MA), and was approved by the House by a 371-16 vote. While the Senate did not act on the measure, a bipartisan companion bill was introduced in the Senate.⁴

In addition, others have made recommendations to improve regulatory oversight of ILCs. As Congress deliberated and drafted the Dodd-Frank Act in 2009 and 2010, the Treasury Department made the following recommendation:

“All companies that control an insured depository institution, however organized, should be subject to robust consolidated supervision and regulation at the federal level by the Federal Reserve and should be subject to the nonbanking activity restrictions of the BHC Act. The policy of separating banking from commerce should be re-affirmed and strengthened. We must close loopholes in the BHC Act for ... industrial loan companies....”⁵

and controlling the relationship between an insured entity and its parent company is an important part of the banking agencies' approach to supervision.”).

² Statement of Sheila C. Bair, Former FDIC Chairman, before the House Financial Services Committee on H.R. 698, The Industrial Bank Holding Company Act of 2007 (Apr. 25, 2007), <http://archives.financialservices.house.gov/hearing110/ht042507.shtml>.

³ <https://www.congress.gov/bill/110th-congress/house-bill/698>

⁴ S.1356, the Industrial Bank Holding Company Act of 2007 introduced by Sen. Sherrod Brown (D-OH) and former Sen. Wayne Allard (R-CO), <https://www.congress.gov/bill/110th-congress/senate-bill/1356>.

⁵ Department of the Treasury, *Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation* (June 17, 2009) page 34, <https://www.treasury.gov/press-center/press-releases/Pages/20096171052487309.aspx>. (On page 35, Treasury further explains: “Congress added the ILC exception to the BHC Act in 1987. At that time, ILCs were small, special-purpose banks that primarily engaged in the business of making small loans to industrial workers and had limited deposit-taking powers. Today, however, ILCs are FDIC-insured depository institutions that have authority to offer a full range of commercial banking services. Although ILCs closely resemble commercial banks, their holding companies can avoid the restrictions of the BHC Act – including consolidated supervision and regulation by the Federal Reserve – by complying with a BHC exception. Formation of an ILC has been a common way for commercial companies and financial firms (including large investment banks) to get access to the federal bank safety net but avoid the robust governmental supervision and activity restrictions of the BHC Act. Under our plan, holding companies of ILCs would become BHCs.”)

In the interim, Section 603 of the Dodd-Frank Act imposed a three-year moratorium on the FDIC's ability to approve deposit insurance for ILCs and required the U.S. Government Accountability Office ("GAO") to study the issue.⁶ GAO had previously studied ILCs and recommended that Congress consider improving supervision and oversight of ILCs to allow for broader supervision akin to the supervision of bank holding companies.⁷ GAO published its statutorily required report in January 2012, finding that,

"[t]he Bank Holding Company Act of 1956 (BHC Act) establishes the legal framework under which bank holding companies—that is, companies which own or control banks—operate and restricts the type of activities that these companies may conduct. The BHC Act excludes from these restrictions certain companies because the financial institutions they own are exempt from the BHC Act definition of "bank". However, these exempt institutions are eligible for FDIC insurance raising questions about continuing to exempt their holding companies from BHC Act requirements.... These institutions vary by size, activities, and risks. Larger institutions such as ILCs provide banking services similar to those of commercial banks and carry many of the same risks.... OCC officials and representatives of exempt institutions viewed the current oversight was sufficiently robust. FDIC officials indicated that supervision of the exempt institutions themselves was adequate, but noted that consolidated supervision authorities provide important safety and soundness safeguards. Officials from the Federal Reserve and Department of the Treasury stated that the exemptions should be removed, given that exempt institutions have access to FDIC insurance and the holding companies of most types of exempt institutions are not subject to consolidated supervision. The implications of subjecting exempt institutions and their holding companies to the BHC Act vary."⁸

Additionally, pursuant to Section 620 of the Dodd-Frank Act, Federal banking regulators issued a report to Congress and the Financial Stability Oversight Council in which the Board of Governors of the Federal Reserve System recommended, among other things, that Congress, "repeal the exemption that permits corporate owners of industrial loan companies (ILC) to operate outside of the regulatory and supervisory framework applicable to other corporate owners of insured depository institutions."⁹

The aforementioned concerns highlighted by the Federal Reserve and others regarding whether ILCs should be required to comply with the BHC Act have also been raised by stakeholders

⁶ See S. Rept. 111-176, the Restoring American Financial Stability Act of 2010, at page 83, <https://www.congress.gov/111/crpt/srpt176/CRPT-111srpt176.pdf>.

⁷ See GAO, *Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority*, (Sep. 15, 2005), <http://www.gao.gov/products/GAO-05-621>. ("Industrial loan corporations (ILC) emerged in the early 1900s as small niche lenders that provided consumer credit to low and moderate income workers who were generally unable to obtain consumer loans from commercial banks. Since then, some ILCs have grown significantly in size, and some have expressed concern that ILCs may have expanded beyond the original scope and purpose intended by Congress. Others have questioned whether the current regulatory structure for overseeing ILCs is adequate.... GAO is not recommending executive action but believes Congress should consider strengthening the regulatory oversight of ILCs...")

⁸ GAO, *Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions* (Jan. 19, 2012), <http://www.gao.gov/products/GAO-12-160>.

⁹ Board of Governors of the Federal Reserve System, FDIC and the Office of the Comptroller of the Currency, *Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act* (Sep. 2016), page 28, <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160908a1.pdf>.

commenting on SoFi's application. For example, in the Independent Community Bankers of America ("ICBA")'s comment letter on SoFi's application, the group wrote,

"[f]or safety and soundness reasons and to maintain the separation of banking and commerce, the FDIC should deny SoFi Bank's application and impose a moratorium on future ILC deposit insurance applications. SoFi should be subject to the same restrictions and supervision that any other bank holding company of a community bank is subject to. Furthermore, Congress should close the ILC loophole because it not only threatens the financial system but creates an uneven playing field for community banks....Congress should immediately address this issue and permanently close the ILC legal loophole before it is too late and we have huge commercial or technology firms like Amazon, Google or Wal-Mart owning FDIC-insured ILCs and operating them without adequate holding company supervision and without any restrictions on the types of activities in which the holding company or the ILC's affiliates can engage."¹⁰

These concerns regarding the regulation of ILCs generally, and concerns about extending the existing regulatory framework of ILCs to fintech companies, should be carefully considered, including whether it is appropriate for firms like SoFi to have access to Federal deposit insurance by simply establishing a state-chartered ILC. Holding a public hearing on SoFi's application would provide an additional opportunity to weigh these concerns before acting on the application.

II. Shortcomings of existing regulatory authority for fintech companies

While some experts have touted the possibility that fintech firms can help promote financial inclusion, others have underscored the challenges posed for our current regulatory regime to oversee these types of companies and have underscored the need for policymakers to carefully evaluate the consequences of allowing them access to deposit insurance and the Federal Reserve discount window¹¹. Thus, Federal regulators have taken a varying degree of actions focused on fintech companies and services. For example, while the Office of the Comptroller of the Currency ("OCC"), under its "Responsible Innovation" initiative, has proposed a Special

¹⁰ ICBA letter to FDIC, (July 18, 2017). *Also see* Letter from Americans for Financial Reform (AFR) to FDIC, *RE: 20170820 - SoFi Bank - Deposit Insurance (New Bank)*, (July 18, 2017).

¹¹ *See* U.S. Department of the Treasury, *Opportunities and Challenges in Online Marketplace Lending*, (May 10, 2016), <https://www.treasury.gov/connect/blog/Pages/Opportunities-and-Challenges-in-Online-Marketplace-Lending.aspx>; National Economic Council, *A Framework for FinTech* (Jan. 13, 2017), <https://obamawhitehouse.archives.gov/blog/2017/01/13/framework-fintech>; and Congressional Research Service, *Marketplace Lending: Fintech in Consumer and Small-Business Lending*, (Sep. 6, 2016), ("Some observers assert that marketplace lending may pose an opportunity to expand the availability of credit to individuals and small businesses in a fair, safe, and efficient way. Marketplace lenders may have lower costs than traditional lenders, potentially allowing them to make more small loans than would be profitable for traditional lenders. In addition, some observers believe the accuracy of credit assessments will improve by using more data and advanced statistical modeling, as marketplace lenders do through their automated algorithms, leading to fewer delinquencies and write-offs. They argue that using more comprehensive data could also allow marketplace lenders to make credit assessments on potential borrowers with little or no traditional credit history. Other observers warn about the uncertainty surrounding the industry and the potential risks marketplace lending poses to borrowers, loan investors, and the financial system. The industry only began to become prevalent during the current economic expansion and low-interest-rate environment, so little is known about how it will perform in other economic environments. Many marketplace lenders do not hold the loans they make themselves and earn much of their revenue through origination and servicing fees, which potentially creates incentives for weak underwriting standards. Finally, some observers argue that lack of oversight may allow marketplace lenders to engage in unsafe or unfair lending practices.").

Purpose National Bank Charter for fintech companies (“fintech charter”)¹² questions have been raised about whether the benefits to consumers for this new charter will be widely and fairly shared, and whether there is adequate legal authority, let alone a clearly defined and modern regulatory framework, for such a fintech charter.¹³ Indeed, a lawsuit has been filed by state banking regulators challenging the OCC’s authority.¹⁴ As should be the case with the OCC and its proposal to use its authority to federally charter fintech companies, the FDIC should thoroughly consider the implications of offering access to the deposit insurance fund for ILCs that will result in expanding the type of institutions to it, like fintech firms. Fintech firms, whose operations cross state and international boundaries, and may exist entirely online, were undoubtedly beyond original congressional intent in permitting ILCs to access deposit insurance and it is appropriate for stakeholders to weigh in on whether it is appropriate for these firms to have this access without proper oversight of their parent companies.

SoFi was established six years ago¹⁵ as “a new kind of finance company taking a radical approach to lending and wealth management.”¹⁶ Granting SoFi’s application would set a precedent that a wide variety of other fintech companies may choose to follow even though concerns related to financial inclusion, consumer benefits, supervision, and regulation of such entities are still unresolved. Thus, the FDIC should carefully consider these concerns when reviewing SoFi’s application, and in doing so, hold a public hearing to allow for a fuller vetting of the advantages and disadvantages of extending an outdated regulatory framework for ILCs to fintech companies, and the potential implications for the broader financial system. Importantly, the public hearing could also shed more light on whether it may be more prudent for the FDIC to work with Congress to design a Federal regulatory framework for fintech companies. I would welcome your input for such an undertaking.

III. Consumer protection concerns

The chartering of a fintech company as an ILC also raises a number of consumer protection concerns that the FDIC should consider. For example, the California Reinvestment Coalition (“CRC”) has opposed SoFi’s application on the basis of concerns with the institution’s Community Reinvestment Act (“CRA”) plan, as well as its intended approach to financial inclusion, fair lending, and consumer protection.¹⁷ CRC notes that SoFi’s business model targets “students from elite universities that have strong earnings and wealth potential,” and offers products and services “designed to exclude working class households.” CRC also notes that SoFi’s CRA plan is grossly inadequate, considering that: (1) SoFi’s assessment area will be limited to areas in Utah, but the company will accept deposits and operate nationally; (2) SoFi’s

¹² <https://occ.gov/topics/responsible-innovation/index-innovation.html>

¹³ See OCC, *Public Comments on Exploring Special Purpose National Bank Charters for Fintech Companies*, <https://www.occ.gov/topics/responsible-innovation/fintech-charter-comments.html>, including comments from the Independent Community Bankers Association, Conference of State Bank Supervisors, National Consumer Law Center and National Community Reinvestment Coalition.

¹⁴ <https://www.csbs.org/news/press-releases/pr2017/Pages/042617.aspx>

¹⁵ Ann Carns, *SoFi Tapping Alumni to Help With Student Loans*, NEW YORK TIMES (Apr 3, 2012), <https://bucks.blogs.nytimes.com/2012/04/03/sofi-tapping-alumni-to-help-with-student-loans/>.

¹⁶ SoFi, *Our Story*, <https://www.sofi.com/our-story/>, (accessed on Aug. 7, 2017).

¹⁷ CRC letter to Kathy Moe, Regional Director, FDIC, *RE: CRC opposition to application by SoFi for an industrial bank charter* (July 18, 2017). CRC’s comment letter also notes that the Consumer Financial Protection Bureau’s complaint database includes 42 complaints by SoFi’s customers over the past two years related to improper fees, poor customer service, and loan fees; *see also*, National Community Reinvestment Coalition (“NCRC”) letter to FDIC, *RE: NCRC Comment Letter on SoFi Charter Application* (July 18, 2017).

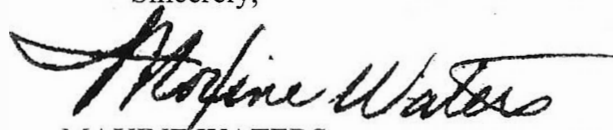
current core products are not designed to serve the “convenience and needs” of low- and moderate-income (“LMI”) communities in which the bank would operate,¹⁸ but rather are focused on serving SoFi’s members; and (3) SoFi’s CRA plan does not encompass measurable commitments to lending, investments, and services for LMI communities. CRC wrote:

“[t]he proposed bank’s CRA plan is woefully inadequate in terms of which communities will be served, and how they will be served. Perhaps most significantly, the Bank undermines the goals of the CRA by proposing to lend and take deposits nationally, but reinvest only locally, in the Salt Lake City area. The intent of the CRA is to ensure that banks, which benefit from various federal government subsidies, protections and rules, meet community credit needs by reinvesting deposits back into the communities from which they originated. Most likely, Salt Lake City and environs will comprise only a miniscule portion of the would-be bank’s deposits.... The Bank will be focusing on its existing SoFi members, and SoFi indicates that these members live in the top 10 metropolitan areas within the USA. It can be assumed that a plurality of SoFi deposits will come from these 10 metro areas. The Bank should clearly accept these 10 metro areas as part of its CRA assessment area.”¹⁹

Although companies are free to offer products and services based on their market choices, institutions must follow the law and should not be able to benefit from Federal deposit insurance if they are deliberately choosing to not provide financial services to the most vulnerable, underserved, and underbanked individuals in the country. The FDIC should gather more evidence regarding the financial inclusion, fair lending, and consumer protection concerns that arise from SoFi’s application by convening a public hearing.

In conclusion, there are a number of important policy and legal issues at stake with SoFi’s application that warrant the FDIC holding a public hearing.

Sincerely,


MAXINE WATERS

¹⁸ *Id.* CRC letter. CRC notes that SoFi’s CRA plan identifies lending to LMI consumers through credit cards that “charge a much higher interest rate north of 20% percent.” CRC also stated “the fact that the bank’s main CRA loan product is a high interest rate credit card is unacceptable.”

¹⁹ *Id.* CRC Letter; *see also*, NCRC letter.



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July 18, 2017

Kathy Moe
Regional Director
FDIC San Francisco Regional Office
25 Jessie Street at Ecker Square
San Francisco, California 94105

Dear Ms. Moe:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the federal deposit insurance application of SoFi Bank. According to the application, Social Finance, Inc. (SoFi) seeks to establish an industrial loan corporation or an industrial bank (ILC) chartered by the state of Utah for the purposes of providing its customers an FDIC insured NOW account and a credit card product. The bank will offer no other products and services and the proposed ILC will be 100% owned by SoFi and will be named SoFi Bank, a wholly owned subsidiary of SoFi.

SoFi Bank will be an online-only bank with no branches. SoFi intends to capitalize SoFi Bank with \$166 million in cash and will invest \$4 million to fund bank organization expenses. In addition to the cash capitalization, SoFi will also contribute the core-banking system it acquired in its Zenbanx acquisition earlier this year. Arkadi Kuhlmann, who was the founder, chairman and CEO of ING Direct, will be the CEO of SoFi Bank.

ICBA's Comments

ICBA's main objection with the deposit insurance application is SoFi's use of the ILC charter to avoid the legal prohibitions and restrictions under the Bank Holding Company Act (BHCA). The BHCA contains a comprehensive framework for the supervision of bank holding companies and their nonbank subsidiaries. Regulation under the BHCA entails consolidated supervision of the holding company by the Federal

¹ *The Independent Community Bankers of America®, the nation's voice for more than 5,800 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. With 52,000 locations nationwide, community banks employ 760,000 Americans, hold \$4.7 trillion in assets, \$3.7 trillion in deposits, and \$3.2 trillion in loans to consumers, small businesses, and the agricultural community. For more information, visit ICBA's website at www.icba.org.*

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Reserve and restricts the activities of the holding company and its affiliates to those that are closely related to banking, such as extending credit and servicing loans, or performing appraisals of real estate and personal property. Because of a loophole in the law, companies that own ILCs are not subject to BHCA supervision. As a result, a company that owns an FDIC-insured ILC can engage in non-banking commercial activities and not be subject to consolidated supervision.

SoFi Bank is applying as an ILC and not as a commercial bank because its parent company does not want to be subject to the legal restrictions and supervision attendant to the BHCA. **For safety and soundness reasons and to maintain the separation of banking and commerce, the FDIC should deny SoFi Bank's application and impose a moratorium on future ILC deposit insurance applications.** SoFi should be subject to the same restrictions and supervision that any other bank holding company of a community bank is subject to. **Furthermore, Congress should close the ILC loophole because it not only threatens the financial system but creates an uneven playing field for community banks.**

ILCs began in the early 1900s as small, state chartered loan companies that served the borrowing needs of industrial workers who were unable to obtain noncollateralized loans from commercial banks. However, these institutions grew significantly in the 2000s and, like credit unions, evolved from small, limited-purpose institutions to a diverse group of insured financial institutions with a variety of business models engaging in activities that are a far cry from their original purpose.

When Wal-Mart proposed establishing an ILC to engage in banking activities in 2006, ICBA was the first national bank trade association to oppose Wal-Mart's deposit insurance application. ICBA advocated for a permanent closure of the ILC loophole and was particularly concerned with Wal-Mart mixing commerce and banking. In letters to the FDIC, we stated that allowing corporate conglomerates to own banks not only violates the U.S. policy of maintaining the separation of banking and commerce, but jeopardizes the impartial allocation of credit, creates conflicts of interest and a dangerous concentration of commercial and economic power, and unwisely extends the federal safety net to commercial interests.

In June 2009, these concerns were also raised again by the Department of Treasury in the financial regulator reform plan that it presented to Congress. Treasury proposed that all holding companies owning an insured depository institution be subject to the BHCA restrictions and to Federal Reserve supervision, and recommended that Congress close the ILC loophole. Following Treasury's recommendations, Section 603 of the Dodd-Frank Act imposed a three-year moratorium on approving federal deposit insurance for ILCs. ICBA strongly approved of the ILC moratorium and advocated for its extension when the moratorium expired on July 21, 2013.

In January 2012, the GAO, as required under the Dodd-Frank Act, issued a report entitled

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“Bank Holding Company Act—Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions” which discussed the ILC exemption in detail. The GAO report clearly articulated the concerns of both the Federal Reserve and the Treasury Department with the ILC exemption.

For instance, the BHCA establishes a consolidated supervisory framework for assessing the risks to a depository institution that could arise because of its affiliation with other entities in a holding company structure. Consolidated supervision of a bank holding company includes the parent company and its subsidiaries and allows the regulator to understand the organization’s structure, activities, resources and risks and address financial, managerial, operational, or other deficiencies before they pose a danger to the bank holding company’s subsidiary depository institutions.

The Federal Reserve also establishes capital standards for bank holding companies helping to ensure that they maintain adequate capital to support their activities and to make sure they do not become excessively leveraged, and are able to serve as a source of strength to their depository institution subsidiaries. The Federal Reserve also examines holding companies and their nonbank subsidiaries to assess the nature of the operations and the financial condition of the holding company and its subsidiaries, the financial and operational risks within the holding company that may pose a threat to the safety and soundness of any depository institution subsidiary, and the systems for monitoring and controlling such risks.

In contrast, the FDIC does not have consolidated supervisory authority over the holding companies of FDIC-insured ILCs and does not have the authority to look at the entire organization and examine all relationships within the holding company structure--not just what affects only the depository institutions. Furthermore, as was acknowledged by the FDIC and the OCC, holding companies of ILCs are not held to the same risk management and capital standards as bank holding companies and the FDIC cannot take enforcement actions to compel nonbank holding companies to maintain those standards. As the GAO reported,

“Federal Reserve and Treasury officials contend that the BHCA exemptions (like the ILC exemption) represent gaps in the current regulatory structure that pose risks to the financial system” and since these institutions are not subject to consolidated supervision, “potential activities within the holding company...may be missed” because of this “supervisory blind spot.”

The Federal Reserve also warned in its comments to the GAO Report that if Congress did not close the ILC loophole, “the number and size of ILCs could grow to much higher levels than they had reached prior to the financial crisis.” The Federal Reserve also noted that maintaining the ILC exemption resulted in “differing regulatory oversight,” raising questions about whether the exemption provides an “unfair competitive advantage.”

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Although SoFi does not presently engage in the type of commercial activities that Wal-Mart engages in, it certainly would be legally free to do so in the future. In fact, there are no limitations on the types of businesses that SoFi and SoFi Bank's affiliates could legally engage in. For instance, SoFi might want to set up an online retail affiliate that specializes in selling products and services to members of SoFi's community, i.e., millennials who recently graduated from college. SoFi might even become ambitious enough to set up an online retail company that would compete with Amazon. Because of the BHCA exemption, none of these affiliates would be subject to the supervision or examination of the Federal Reserve.

The dangers of mixing commerce and banking are clear enough and were noted in the GAO Report and by the Treasury Department in its 2009 report. For instance, an ILC could be directed to engage in transactions that benefitted the holding company's affiliates but were detrimental to the ILC's safety and soundness. In the case of SoFi Bank, SoFi could encourage SoFi Bank to deny credit to customers of SoFi's competitors or alternatively, could encourage SoFi Bank to offer loans to SoFi's customers based on terms not offered to its competitor's customers. While Section 23A of the Federal Reserve Act restricts the ability of insured depository institutions—including ILCs—to enter into transactions with affiliates, there are still many ways that SoFi could adversely impact SoFi Bank, circumvent the Section 23A restrictions and escape the FDIC's supervision, particularly when there is no consolidated supervision.

In 1999 the Congress debated the issue of mixing banking and commerce as it considered the Gramm Leach Bliley Act. Congress decided not to extend the safety net to commercial firms. It heeded the lessons of the 1980s and the banking collapse of the early 1930s and recognized that the system of deposit insurance was created for the protection of depositors of regulated banks and not for the protection of commercial firms.

Conclusion

For safety and soundness reasons and to affirm the long-standing policy prohibiting affiliations or combinations between banks and non-financial commercial firms, the FDIC should reimpose a moratorium on deposit insurance for ILCs similar to the moratorium that was imposed in 2006 and require SoFi Bank to apply for deposit insurance as a commercial bank and not as an ILC. Furthermore, Congress should immediately address this issue and permanently close the ILC legal loophole before it is too late and we have huge commercial or technology firms like Amazon, Google or Wal-Mart owning FDIC-insured ILCs and operating them without adequate holding company supervision and without any restrictions on the types of activities in which the holding company or the ILC's affiliates can engage.

ICBA appreciates the opportunity to comment on SoFi Bank's deposit insurance application. If you have any questions or would like additional information, please do not

The Nation's Voice for Community Banks.®

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hesitate to contact me by email at [REDACTED].

Sincerely,
/s/ Christopher Cole

Christopher Cole
Executive Vice President and Senior Regulatory Counsel

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August 21, 2019

Kathy Moe
Regional Director
FDIC San Francisco Regional Office
25 Jessie Street at Ecker Square
San Francisco, California 94105

Re: FDIC Deposit Insurance Application of Rakuten Bank America

Dear Ms. Moe:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the federal deposit insurance application of Rakuten Bank America. According to its application, Rakuten Bank America will be an online-only bank with no branches headquartered in Midvale, Utah.

The Bank will provide a wide variety of traditional bank products including consumer loans, consumer credit cards, consumer deposits (NOW, savings, and time), merchant acquiring, commercial loans, and commercial savings accounts. Rakuten says that this product suite was “selected to specifically serve the users of the U.S.-based online marketplace, both consumers and merchants” and that “these offerings will essentially complete the Rakuten U.S. ecosystem, whereby consumers and merchants are served in a common online marketplace that creates loyalty and provides real value to both sets of customers.” Rakuten Bank America will market its products primarily in the existing Rakuten community to consumers who are already existing customers of the Bank’s Rakuten affiliates, including but not limited to Ebates (currently being rebranded as Rakuten) and Rakuten.com.

The direct parent company of Rakuten Bank America is Rakuten Card Co., Ltd., (Rakuten Card Japan). Rakuten Card Japan will contribute \$50 million cash in organizing and startup costs and \$350 million in cash as the initial capital injection. This amount of capital could support a de novo bank growing to approximately \$4 billion in assets.

¹ *The Independent Community Bankers of America®*, the nation’s voice for more than 5,700 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. With 52,000 locations nationwide, community banks employ 765,000 Americans, hold \$4.9 trillion in assets, \$3.9 trillion in deposits, and \$3.3 trillion in loans to consumers, small businesses, and the agricultural community. For more information, visit ICBA’s website at www.icba.org.

Rakuten, Inc.

Rakuten Bank America's parent company is owned by Rakuten, Inc. According to Wikipedia, since Rakuten, Inc. is the largest electronic commerce and internet company in Japan, it is often referred to as the "Amazon of Japan." With total sales worldwide of about \$7.2 billion dollars and with nearly 17,000 employees, Rakuten has enormous commercial interests in online shopping, travel reservations, professional sports (i.e., it owns a professional Japanese baseball team), book distribution, marketing, and data analysis. Rakuten also owns the largest internet bank in Japan.

In the United States, Rakuten significantly expanded its commercial interests by acquiring Buy.com in 2010 which became Rakuten.com. That website offers a series of virtual storefronts for shoppers to browse and connect online providing a "merchant-friendly" experience. Rakuten has also launched e-commerce sites in Germany, Brazil, France, China, Thailand, Malaysia, Indonesia, Taiwan, South Korea, Austria, Russia, Canada and the United Kingdom. In 2014, Rakuten purchased Ebates.com for \$1 billion which now allows customers to earn cash back when shopping online. With 2,600 retailers offering products on Ebates, Rakuten now has a large presence in the US e-commerce market and according to its application, owns 43 different companies in the U.S.

ICBA's Comments

In addition to raising a number of significant legal and regulatory issues, Rakuten Bank America's deposit insurance application is antithetical to the long-established policy in the United States that banking and commerce should be kept separate. In fact, not only at the holding company level but at the bank level, Rakuten Bank America's desire is to link e-commerce with banking so as to create a "synergistic ecosystem" with "leading edge mobile technology." Rakuten says this strategy is a "win-win" for both merchants and consumers.

As we indicated with the Square and SoFi's deposit insurance applications to the FDIC, ICBA's objection to their applications is their use of the ILC charter to avoid the legal prohibitions and restrictions under the Bank Holding Company Act (BHCA). We said that the Square application presented a threat to the separation of banking and commerce since the holding company of Square and its affiliates already engage in a diverse set of commercial activities including a food delivery business, a software business, and an online hardware store. Regulation under the BHCA entails consolidated supervision of the holding company by the Federal Reserve and restricts the activities of the holding company and its affiliates to those that are closely related to banking. Because of a loophole, companies that own ILCs are not subject to BHCA supervision. As a result, a company that owns an FDIC-insured ILC can engage in non-banking commercial activities and not be subject to consolidated supervision.

Banks hold a unique place in the American economy. Banking is not simply a business among other businesses. As independent and neutral arbiters of commercial and consumer credit, banks assess risk and create fair access to credit based on the power of an idea, the track record of

management, the current marketplace, and economic potential. That critical role would be jeopardized if commercial firms were allowed to own or control banks or their functional equivalents. To preserve the character and safety of our economy and to uphold consumer and business confidence in our banks, commercial companies must not be allowed to own banks or bank-like institutions.

Similar to Walmart’s application in 2005, Rakuten Bank’s application presents the mixing of commerce and banking at a new and unprecedented level since Rakuten, Inc.’s e-commerce and other commercial activities are so diverse and operate on a global stage. For instance, in addition to its massive e-commerce activities, the company owns an online marketing business, Rakuten Marketing, and has investments in companies as diverse as Pinterest (a social media web and mobile application company), Ozon.ru (a Russian online retailer) Lyft (a ride-hailing service), Cabify (a Latin American ride-hailing service), Careem (a middle-Eastern transportation startup company), and Carousell (a Singapore-based consumer-to-consumer marketplace app). Rakuten has made several large investments in e-book distribution, electronic publishing, and digital content particularly after purchasing Overdrive, Inc. in the United States and has also made large investments in video-on-demand service companies. In 2004, Rakuten Baseball was created and the baseball team Tohoku Rakuten Golden Eagles was formed and joined the Nippon Professional Baseball League.

Rakuten Bank America is applying as an ILC and not as a commercial bank because its parent company and the company that owns the parent company do not want to divest their commercial activities and be subject to the legal restrictions of the BHCA. **As we stated in our comment letter regarding the Square application, for safety and soundness reasons and to maintain the separation of banking and commerce, the FDIC should deny Rakuten Bank America’s application and impose a temporary moratorium on future ILC deposit insurance applications.** Rakuten, Inc. should be subject to the same restrictions and supervision that any other bank holding company of a full service bank is subject to. **Furthermore, Congress should close the ILC loophole because it not only threatens the financial system but creates an uneven playing field for community banks. This loophole should never be allowed to be exploited by a huge foreign e-commerce company as a way to get into the U.S. banking business without complying with the BHCA.**

If the FDIC approves the Rakuten Bank America application, the consequences to our financial system would be monumental and irreversible. Rakuten’s chief e-commerce competitor in the United States is Amazon and it is not difficult to envision Amazon also wanting to get into the banking business through an ILC. The integration of these technology, e-commerce, and banking firms would not only result in an enormous concentration of financial and technological assets but also would pose conflicts of interest and privacy concerns to our banking system.

If Rakuten, Inc. were to own an ILC, they and its affiliates could accumulate large amounts of financial data on people which, combined with the shopping data they already have from Rakuten.com would pose a strong privacy risk to individuals. Furthermore, Rakuten, Inc. would be tempted to direct its ILC to engage in transactions that benefitted the holding company’s affiliates but were detrimental to the ILC’s safety and soundness. For instance, Rakuten, Inc.

could encourage its ILC to deny credit to customers of its affiliates' competitors or alternatively, could encourage its ILC to offer loans to affiliates' customers based on terms not offered to its competitor's customers.

Furthermore, examining the affiliate relations of Rakuten Bank America will be a tremendous challenge to the FDIC. According to its application, Rakuten Bank America will enter into six master services agreements with various Rakuten affiliates for limited services and four marketing agreements with other affiliates include Ebates, Kobo, Viber and Viki to allow the Bank to market products to their respective customer bases. These services will be provided to the Bank "at or below market rates in compliance with Section 23B of the Federal Reserve Act and Regulation W." **However, since many of these relationships will be with foreign companies, the work will be overwhelming for the FDIC and will require an examination team working an entire year to determine whether these relationships violate Regulation W. We question whether the FDIC has the resources or even the skills to examine and supervise this many different e-commerce affiliate relationships, particularly when so many of them operate overseas.**

In 1999, the Congress debated the issue of mixing banking and commerce as it considered the Gramm Leach Bliley Act and Congress decided to maintain the separation of banking and commerce and not to extend the safety net to commercial firms. It recognized the lessons of the 1980s and the banking collapse of the early 1930s--that our deposit insurance system was created for the protection of depositors of regulated banks and not for the protection of commercial firms.

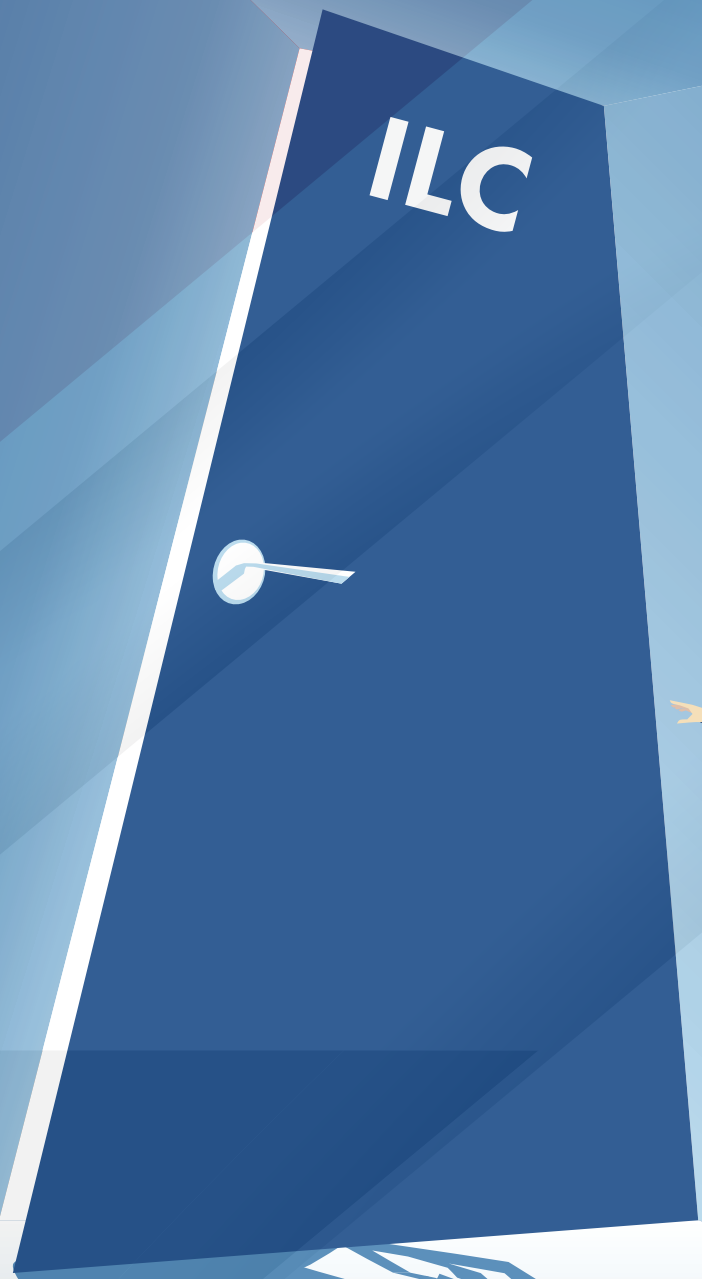
The FDIC should deny Rakuten Bank America's application and impose an immediate moratorium on ILC deposit insurance applications. Furthermore, Congress should immediately address this issue and permanently close the ILC legal loophole before it is too late and we have these large e-commerce and technology firms owning FDIC-insured ILCs and operating them without adequate holding company supervision and without any restrictions on the types of activities in which the holding company or the ILC's affiliates can engage.

The implications to our financial system and economy of a Rakuten Bank America ILC are enormous and illustrate exactly why the U.S. policy has been to separate banking and commerce for the good of the economy, consumers and businesses alike.

ICBA appreciates the opportunity to comment on Rakuten Bank America's deposit insurance application. If you have any questions or would like additional information, please do not hesitate to contact me by email at [REDACTED]

Sincerely,
[REDACTED]

Christopher Cole
Executive Vice President and Senior Regulatory Counsel



**INDUSTRIAL
LOAN
COMPANIES:
CLOSING THE
LOOPHOLE TO AVERT
CONSUMER AND
SYSTEMIC HARM**

March 2019

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Executive Summary and Introduction

- A loophole in the Bank Holding Company Act allows commercial companies and fintech companies to own or acquire industrial loan companies (ILCs) chartered by Utah and a handful of other states without being subject to federal consolidated supervision, leaving a dangerous gap in safety and soundness oversight.
- ILCs are the functional equivalent of full-service banks. Commercial company ownership of ILCs will effectively combine banking and commerce, contrary to long standing American economic policy. Federal law prohibits all other full-service banks, whether federally or state chartered, from being owned by commercial companies.
- In the new era of big data, social media and e-commerce conglomerates, artificial intelligence, and financial technology, we should be cautious before giving these companies yet more reach into the economic lives of Americans.
- Federal Deposit Insurance Corporation approval of new ILC deposit insurance applications would put the federal safety net, and ultimately the American taxpayer, at risk.
- A single state, Utah, representing less than 1 percent of the U.S. population, should not be allowed to unilaterally determine national financial regulatory and economic policy.
- Any such far-reaching change should be debated by Congress. ICBA supports statutory closure of the ILC loophole.
- ICBA urges the FDIC to impose an immediate moratorium on the approval of deposit insurance for ILCs.

Banks hold a unique place in the American economy. Banking is not simply a business among other businesses. As independent and neutral arbiters of commercial and consumer credit, banks assess risk and create fair access to credit based on the power of an idea, the track record of management, the current marketplace, and economic potential. That critical role would be jeopardized if commercial firms were allowed to own or control banks or their functional equivalents.

The longstanding American policy of separation of banking and commerce, as embodied in the Bank Holding Company Act (BHCA), must not be compromised or eroded. To preserve the character and safety of our

economy and to uphold consumer and business confidence in our banks, commercial companies must not be allowed to own banks or bank-like institutions.

In the new era of dominant “Superstar Firms,”¹ Big Data, social media and e-commerce conglomerates, artificial intelligence, and financial technology, we should be cautious before giving these companies yet more reach into the economic life of Americans.



The industrial loan company charter, a full-service banking charter, is a stalking horse for this potential shift in policy. A loophole exists in the Bank Holding Company Act that allows commercial companies to own FDIC-insured ILCs without Federal Reserve oversight of the holding company or limitations on non-banking activities. A moratorium on FDIC approval of new ILC deposit insurance applications, first imposed by the FDIC in 2006 (in reaction to ILC applications filed by Walmart, Home Depot and other commercial companies), then by Congress in 2010, expired in 2013. While the FDIC has not approved an ILC applicant for deposit insurance since 2006, several applications have been recently filed which present novel issues that could change the nature of financial services.

These applicants include Square, SoFi Bank, and Nelnet Bank, all of which have holding companies and affiliates that engage in diverse, non-financial, commercial activities. SoFi and Nelnet have withdrawn their applications; Square withdrew and later resubmitted its application, which is currently pending. These companies chose to apply for Utah ILC charters and not commercial bank charters because their parent companies wish to retain their current commercial activities, further engage in new activities unrelated to banking, and avoid consolidated supervision by the Federal Reserve as a bank holding company.

¹ Irwin, Neil, “Are Superstar Firms and Amazon Effects Reshaping the Economy?” New York Times. August 25, 2018. <https://www.nytimes.com/2018/08/25/upshot/big-corporations-influence-economy-central-bank.html> “The biggest companies may be influencing things like inflation and wage growth, possibly at the expense of central bankers’ power to do so.”

Before irreversible steps are taken down this road, ICBA urges the FDIC to impose a moratorium on the issuance of deposit insurance to ILCs. A moratorium would allow the FDIC to thoroughly and thoughtfully examine the evolution of the American financial services industry in recent years and to ensure that new charters will not pose a threat to the FDIC insurance fund and the federal safety net. Developments in the area of financial technology in particular warrant close study and assessment. We believe the ultimate solution is an amendment to the BHCA to permanently close the ILC loophole, just as Congress has closed past loopholes that threatened to undermine consolidated supervision and the separation of banking and commerce.

This white paper will explore the principle of separating banking and commerce, the BHCA, the foundation and transformation of the ILC charter, and the potential of this charter to fundamentally transform the character of American finance.

Part I: Preserve the Separation of Banking and Commerce

We have described ILCs as a stalking horse for the combination of banking and commerce. Let's take a closer look at their key characteristics.

What is an ILC?

ILCs are essentially commercial banks chartered in Utah and a handful of other states.² They enjoy all of the commercial and consumer lending powers of commercial banks. While they are state chartered, they are free to operate nationwide, and there is no ceiling on their asset size or cap on the number of ILC charters that may be issued. ILCs qualify for FDIC insurance because they meet the definition of "state bank" under the Federal Deposit Insurance Act: they are incorporated under the laws of a state and they accept deposits (12 USC 1813(a)(2)). However, they are exempt from the definition of "bank" under the BHCA as amended, which explicitly exempts ILCs provided they are (i) chartered by a state that chartered ILCs as of 1987; and (ii) they do not accept demand deposits; have assets of less than \$100 million; or have experienced no change in control since 1987 (12 USC 1841(c)(2)(H)).

This is the ILC loophole that allows what are functionally full-service, federally insured, commercial banks to be owned by commercial companies and to evade consolidated supervision. The only limitation on ILCs, that they cannot accept demand deposits, is easily circumvented by offering functionally equivalent negotiable order of withdrawal (NOW) accounts.³

² In addition to Utah, Nevada, California, Hawaii, and Minnesota have ILCs. Nineteen of the 34 existing ILCs are chartered in Utah. All of the commercially owned ILCs are chartered in either Utah or Nevada. California has barred commercial ownership of ILCs.

³ Demand deposits" are deposits that may be withdrawn at any time and do not require prior notice of withdrawal to be given to the depository institution. Though prohibited from offering demand deposits, ILCs are able to offer negotiable order of withdrawal (NOW)

Later in this paper we explore the explosive growth of ILCs after the creation of the loophole in 1987.

Why separate banking and commerce

The separation of banking and commerce is a long-standing principle of American economic policy. It was first embodied in statute in the 1956 Bank Holding Company Act (the BHCA), which created a formal definition of a bank holding company, established consolidated supervision, and limited the activities of bank holding companies to those closely related to banking, effectively separating the business of banking from “pure” commercial activities. The Act also created loopholes, some of which have since been closed by Congress. As discussed later in this paper, the ILC loophole is a product of later amendments to the BHCA. Changes in the financial marketplace have made this loophole increasingly dangerous.



In response to the stock market crash of 1929 and the subsequent economic depression, the Glass-Steagall Act of 1933 prohibited banks from engaging in securities dealing and underwriting and affiliating with securities firms, though it did not prohibit the ownership of commercial banks by non-banking firms.

Nevertheless, concern about the use of holding companies to concentrate economic power and calls for congressional action rose during the 1930s. In 1938, President Franklin D. Roosevelt sent a special message to Congress urging the passage of legislation enhancing antitrust protections against undue concentration of economic power in the hands of private businesses, including bank holding companies. Roosevelt feared the anti-democratic effect of economic monopolies. “Close financial control, through interlocking spheres of influence over channels of investment, and through the use of financial devices like holding companies and strategic minority interests, creates close control of the business policies of enterprises which

accounts, which are interest-bearing savings accounts on which drafts may be written. Because the deposit-taking institution reserves the legal right to require notice before funds may be withdrawn, NOW accounts technically do not constitute “demand deposits,” but are the functional equivalent.

masquerade as independent units.”⁴ Roosevelt urged Congress to pass legislation that would have, among other restrictions, banned a holding company or any corporation or enterprise in which it is financially interested to borrow from or sell securities to a bank in which it holds stock.

The Bank Holding Company Act

In the 1940s and 1950s, diversified bank holding companies grew in number and size. The Transamerica Corporation was symbolic of this trend. In the early 1950s, Transamerica owned 46 banks, a large share of Bank of America, an insurance company, real estate and oil development firms, and a fish-packing company. This is the historical context in which Congress considered the BHCA.

There were two objectives in the enactment of the BHCA: prohibiting the mixing of banking and commerce; and preventing the use of holding companies to circumvent restrictions on interstate banking. The common theme was concentrations of economic power, across states and across industries.

Barriers to interstate banking were removed by Congress in 1994 with the enactment of the Riegle-Neal Interstate Banking Act. Today we live in an age of large, national banks. ICBA supports enhanced regulation of too-big-to-fail banks to ensure a balanced marketplace that serves all communities and to prevent such banks from leveraging taxpayer subsidies and putting the national economy at risk—again. However, we recognize that national banks play an important role in serving large national and global corporations and fulfilling other functions that require a large scale.

The second objective of the BHCA, separation of banking and commerce, is as important today as it was 60 years ago when the act passed, and indeed takes a new, ominous aspect in the age of big data.

While bank holding companies existed prior to the BHCA, the 1956 act redefined a bank holding company as any company that held a stake of 25 percent or more of the shares of two or more banks or had similar control of voting rights. Stake holding included outright ownership as well as control of or the ability to vote on shares. For the purposes of the law, a bank was defined as any institution that takes deposits and makes loans.

4 Roosevelt, Franklin D. "Message to Congress on Curbing Monopolies." April 29, 1938. <http://www.presidency.ucsb.edu/ws/?pid=15637> "Private enterprise is ceasing to be free enterprise and is becoming a cluster of private collectivism: masking itself as a system of free enterprise after the American model, it is in fact becoming a concealed cartel system after the European model." In addition: "Interlocking financial controls have taken from American business much of its traditional virility, independence, adaptability and daring—without compensating advantages. They have not given the stability they promised."

All BHCs are required to register with, and become subject to consolidated regulation and supervision by, the Federal Reserve. BHCs submit mandatory periodic reports to the Federal Reserve and are subject to its direct examination authority. The Federal Reserve has extensive enforcement powers over BHCs, which are subject to capital adequacy regulation and must serve as a “source of strength” to their bank subsidiaries.

In addition, the BHCA addressed the mixing of banking and commerce by restricting permissible activities and investments of BHCs to banking, managing or owning banks, and a limited set of activities determined to be “closely related to banking.” The BHCA required all bank holding companies to divest themselves of ownership in any firms that were involved in nonbank activities, i.e. commercial and industrial businesses.

The basic framework of the BHCA has endured for more than 60 years, though it has been updated through amendments to reflect the evolution of the American financial marketplace. “Gradually ... the key policy focus of the BHCA regime began to shift toward defining the legal scope of permissible banking and ‘closely related to banking’ activities.”⁵

Amendments to the BHCA: Reaffirming the separation of banking and commerce



A brief review of the history will help explain how we got where we are today and clarify the need to close the ILC loophole.

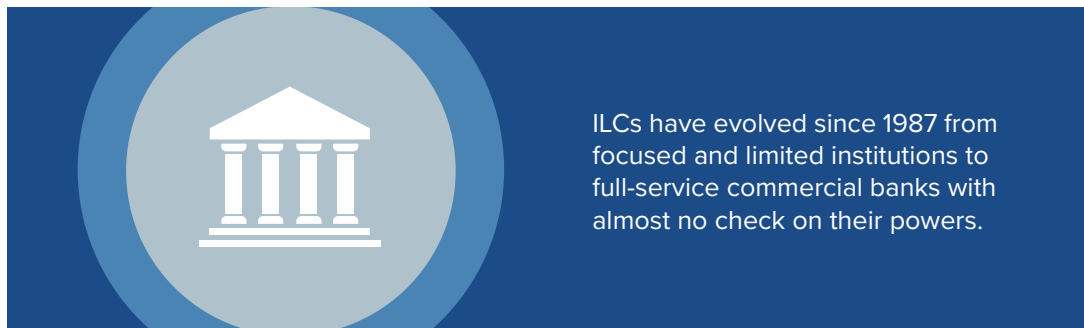
The first amendments to the BHCA were in 1966 when Congress narrowed the scope of the Act by redefining “bank” to refer only to institutions that accepted demand deposits, or deposits that may be withdrawn at any time and do not require prior notice of withdrawal to be given to the depository institution. This created a loophole for commercial companies to own bank-like subsidiaries provided these subsidiaries did not accept demand deposits. In 1970, Congress amended the BHCA to close the single-bank holding company loophole. In the original BHCA, a bank holding company had to control two or more banks. Congress made this change following a

⁵ Omarova, Saule T. and Margaret, Tahyar E., “That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulations in the United States” (2012). Cornell Law Faculty Publications. Paper 1012. <http://scholarship.law.cornell.edu/facpub/1012>

dramatic rise in the number of single-bank holding companies. The 1970 amendments also opened a new loophole by defining a bank as an entity that both accepts demand deposits and makes commercial loans. In the years following the 1970 amendments, a number of “non-bank banks” arose that either did not accept demand deposits or did not make commercial loans but otherwise functioned much like commercial banks. Household names such as Sears, J.C. Penny, Aetna, Merrill Lynch, and Gulf & Western acquired non-bank banks for a variety of purposes such as credit card lending and in-house payments processing.

Pressure from the Federal Reserve, the small business community, and financial market participants including ICBA and community banks led to enactment of the Competitive Banking Equality Act (CEBA) in 1987. CEBA closed the “non-bank bank” loophole, though it grandfathered existing non-bank banks.

Significantly, CEBA also exempted from the definition of “bank” certain categories of financial institutions, including ILCs, credit card banks, limited purpose trust companies, credit unions, and savings associations (or thrifts). Why did Congress exempt these categories of institutions? “These institutions were viewed as relatively small local institutions with a specialized focus and limited range of activities, centering primarily on consumer financial services.”⁶ With the exception of thrifts, these exemptions remain in effect today.⁷ However, credit card banks and trust companies remain limited purpose institutions, true to the spirit and intent of the CEBA exemptions.



Subsequent amendments to the BHCA, the Gramm-Leach-Bliley Act of 1999 and the Dodd-Frank Act of 2010, have reaffirmed the separation of banking and commerce. Congress has consistently acted to close loopholes in the

⁶ Omarova and Tahyar. Page xxx.

⁷ The Savings and Loan Holding Company Act, which is now defunct, ran parallel to the BHCA and imposed comparable activities restrictions on holding companies of more than one thrift. These restrictions did not apply to unitary thrift holding companies (holding only a single thrift). As a result, In the late 1990s, Ford Motor Company, Sears Roebuck and Company, ITT Corporation and Weyerhaeuser Company were among the many commercial companies that owned thrift institutions.” (Omarova and Tahyar, p. 184-185) The unitary thrift loophole was closed by the Gramm-Leach-Bliley Act in 1999.

Act and prevent the mixing of banking and commerce and has only allowed exceptions for limited, narrowly focused institutions.

It is time for Congress to revisit the BHCA and close the ILC loophole which threatens to undermine the BHCA and permit mixing of full-service banking and commerce.

Part II: Regulatory “Blind Spots”: The ILC Loophole Is a Threat to Safety and Soundness

ILCs are a threat to safety and soundness primarily because their commercial owners are exempt from consolidated supervision.

Consolidated supervision

One of the two key provisions of the BHCA is consolidated supervision of the holding company and its affiliates as a group (the other is the separation of commercial activities from banking). According to the Federal Reserve’s Bank Holding Company Supervision Manual: “Financial trouble in one part of an organization can spread rapidly to other parts of the organization; moreover, large BHCs increasingly operate and manage their businesses on an integrated basis across corporate boundaries. Risks that cross legal entities or that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one of the legal entity subsidiaries within the overall organization.”⁸ This is the rationale for consolidated supervision of the parent company and its subsidiaries. Consolidated supervision “allows the Federal Reserve to understand the organization’s structure, activities, resources, and risks, as well as to address financial, managerial, operational, or other deficiencies before they pose a danger to the BHC’s subsidiary depository institutions.”⁹

ILC holding companies not subject to consolidated supervision

Because ILCs are exempt from the BHCA, ILC parent companies are not subject to consolidated supervision. The FDIC, as regulator of the ILC subsidiary, does have limited authority to examine the commercial parent. However, this authority is not remotely comparable to the Federal Reserve’s consolidated supervision of bank holding companies, savings and loan holding companies, and financial holding companies. According to the Government Accountability Office “Federal Reserve officials noted that no federal regulator was assigned to look at the health of the entire holding company for an exempt institution...creating a potential regulatory ‘blind

⁸ “Bank Holding Company Supervision Manual.” Federal Reserve Bank.

⁹ Ibid.

spot.”¹⁰ The FDIC’s authority to examine the commercial parent is limited to what affects the ILC. The FDIC would need a complete picture of the commercial parent, its risk management practices, and its capital standards in order to ensure commercial ownership does not threaten the federal safety net.

Holding company source of strength doctrine is of limited value without consolidated supervision of commercial parent companies

Under U.S. banking law, the parent company of an insured depository institution is expected to serve as a “source of financial strength” to its subsidiary. This means that the parent company must have the ability to inject cash into a struggling bank under its control. Conversely, regulators must ensure that if the parent company experiences difficulties, it will not drain the bank’s liquidity in order to prop itself up. A subsidiary bank must not be a source of strength to its holding company. Holding companies are created to strengthen safety and soundness, not weaken it. This doctrine has been in effect for bank holding companies for several decades. It was formalized in the Dodd-Frank Act and extended to thrift holding companies and to non-financial parents of insured depositories, including ILCs.

However, without consolidated supervision, regulators cannot effectively enforce the source of strength doctrine for commercial ILC holding companies. The FDIC’s authority to examine an ILC parent is limited to aspects of its operations that affect the ILC.¹¹ Moreover, the FDIC has no authority to examine a non-financial affiliate of the holding company (a sibling affiliate of the ILC), but the failure of such an affiliate could stress the parent and impair its ability to serve as a source of strength for the ILC. Finally, holding companies of ILCs are not held to the same risk management and capital standards as bank holding companies.¹²

Current regulations govern transactions among affiliates, including quantitative limits, collateral requirements, consistency with safe and sound practices, and a requirement that transactions occur on market terms. However, without consolidated supervision of the holding company, these restrictions have limited value. Monitoring inter-affiliate transactions under a commercial holding company for conflicts of interest will strain the resources of the FDIC.

Even if ILC parents were subject to consolidated supervision, banking regulators do not have the knowledge or expertise to examine commercial

¹⁰ “Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions.” Government Accountability Office. January 2012. Page 24.

¹¹ Government Accountability Office.

¹² Ibid.

holding companies whose governance functions, risk controls, financial operations and accounting practices are starkly different from those of a financial company.



These companies are reinventing traditional business models. It's fair to say that such an examiner would be out of their depth.

Risk to the federal safety net

In 2017, then Acting Comptroller of the Currency Keith Noreika suggested that the historic policy of separating banking and commerce should be revisited in the name of corporate diversification. "It's not the best thing to put all your eggs in one basket," as he put it.¹³ This sounds sensible enough. In a diversified portfolio, losses in one investment are offset by gains in another. Noreika suggests that a holding company should comprise many baskets – or affiliates – to protect itself from overall losses. But should a federally insured banking affiliate prop up losses in a commercial affiliate? This is not the defined purpose of federal deposit insurance. Moreover, consolidation would create fewer, larger, conglomerate baskets, and each one would be "too-big-to-fail" because of the economic harm that would result due to its increased systemic importance.¹⁴ These conglomerates, being too-big-to-fail, would be able to finance themselves at below market rates because of the perception that the government would bail them out if they were at risk of failure. Subsidized borrowing would only increase their dominance in the marketplace, perpetuating a cycle of private gains and socialized losses.

Part III: Growth of the ILC Industry

At the time that Congress created the ILC loophole in 1987, ILCs were very small institutions and operated with limited powers. Their primary business was making small loans to industrial workers who could not otherwise find

¹³ Reported by Clozel, Lalita. "OCC Takes First Step Toward Rolling Back Volcker Rule." The American Banker. July 19, 2017. <https://www.americanbanker.com/news/occ-to-take-first-step-toward-rolling-back-volcker-rule>

¹⁴ Wilmarth. "Beware the Return of the ILC." "Creditors will expect that large banking-industrial conglomerates will benefit from "too big to fail" treatment during the next financial crisis, as GE and GMAC did last time." <https://www.americanbanker.com/opinion/beware-the-return-of-the-ilc>

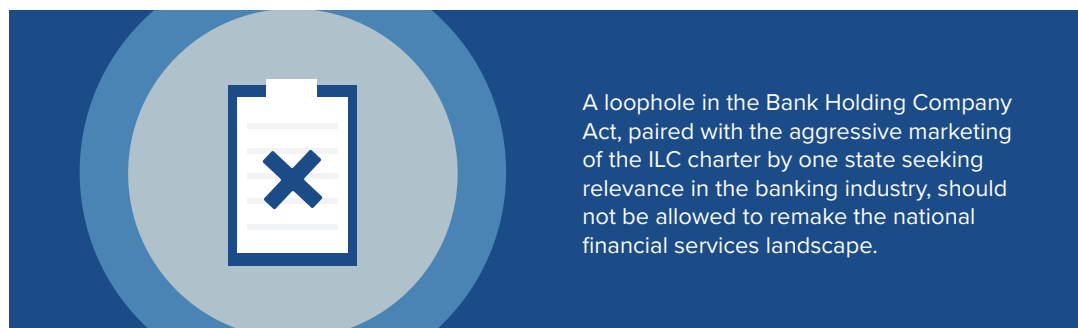
credit, the purpose for which they were originally created in 1910. The largest ILC in 1987 had assets of \$410 million, and the average ILC had assets of \$45 million. Total assets held by ILCs were less than \$4 billion. In 1987, states were not actively chartering new ILCs, and Utah had imposed a moratorium on new charters. What's more, there were restrictions on interstate banks that effectively blocked the expansion of ILCs. Congress could not have envisioned the expanding scope of ILCs that would occur in the ensuing decades.

National financial and economic policy should not be driven by a single state

In 1997, Utah lifted its moratorium on the chartering of new ILCs, allowed ILCs to call themselves “banks,” and permitted them to exercise virtually all of the powers of state-chartered commercial banks. Utah, and to a lesser extent Nevada, began to actively charter new ILCs and promote ILCs as a method for companies to acquire a bank while avoiding the requirements of the BHCA. As noted above, Congress closed the unitary thrift loophole in 1999. Because of this, commercial firms shifted their focus to the ILC as the last available method of acquiring banking powers.¹⁵ Utah is overwhelmingly the source of these new ILC charters.

Since 1997, there has been a dramatic expansion in the number and size of ILCs. Between 1997 and 2006 the number of ILC charters doubled to 56. Total ILC assets grew from \$25.1 billion to \$212.8 billion. The largest ILC was \$60 billion, dwarfing the size of the average community bank, which has assets of \$200 million. There were six ILCs with assets over \$10 billion, and 12 with assets of more than \$1 billion. ILCs were owned by prominent companies such as Toyota, Merrill Lynch, and Goldman Sachs.

Since the 2006 FDIC moratorium and the subsequent financial crisis, which led some of the ILC parents to become financial holding companies, the number of ILCs has dropped to 34 today, and total ILC assets now stand at \$102.4 billion.



¹⁵ Alvarez, Scott G., Testimony before the Senate Committee on Banking, Housing, and Urban Affairs. October 4, 2007.

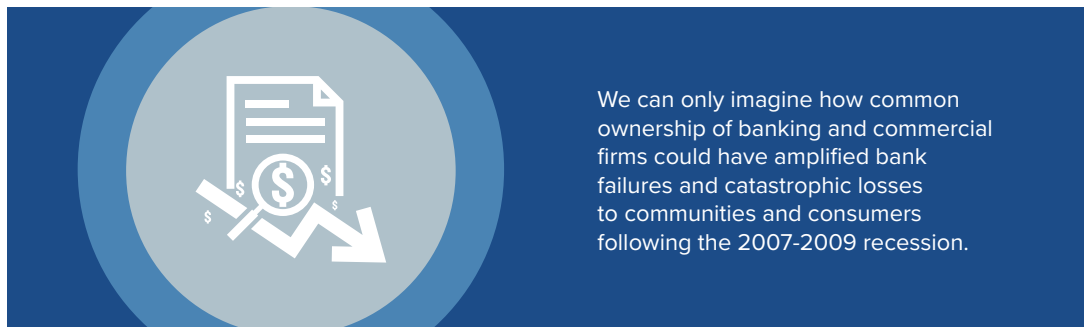
The FDIC should reimpose its moratorium on deposit insurance applications for ILCs, and Congress – not Utah or any other state – should determine commercial ownership of financial institutions.

Walmart ILC application and the FDIC/Dodd Frank Act moratoria

In 2006, eight ILC deposit insurance applications were pending before the FDIC and an additional three had been withdrawn or returned. In addition, seven notices of change in bank control to acquire an ILC were submitted that year of which five were withdrawn. None of the parent companies would have been subject to consolidated supervision. Nine of the 18 potential parent companies were commercial. Applicants included mega-retailers such as Walmart and Home Depot, auto companies Ford and Daimler Chrysler, and private equity firm J.C. Flowers. The Walmart application in particular generated significant controversy among the public, industry, and members of Congress.¹⁶

The FDIC and Congress were right to act as they did in imposing a moratorium when faced with the prospect of an irreversible transformation of the American financial services landscape and concern about the consequences for safety and soundness and for the character of the American commercial life. To date, the concerns that led to the FDIC moratorium in 2006 and the Dodd Frank Act moratorium in 2010 remain unresolved. In fact, as described below, there is more cause for concern today.

If commercial holding companies are allowed to enter banking through the acquisition of ILCs, any remaining barriers to combining banking and commerce will completely erode. The financial landscape could be transformed in a very short period of time.¹⁷



¹⁶ Federal Deposit Insurance Corporation. “Moratorium on Certain Industrial Loan Company Applications and Notices.” Federal Register, August 1, 2006. “The FDIC also received more than 13,000 comment letters and heard substantial testimony in three days of hearings on the proposed Wal-Mart Bank’s deposit insurance application. Most of the comments and testimony expressed opposition to the granting of deposit insurance to this particular applicant... over 640 of those comments specifically raised concerns over the risk to the deposit insurance fund posed by an ILC that has a parent without a consolidated Federal supervisor or in which an ILC is owned or affiliated with a commercial concern.” Congressional hearings were held and bills were introduced affecting ILCs.

¹⁷ Alvarez.

Part IV: ILCs a Path to More Corporate Consolidation and Concentration of Power

The barrier that has existed between banking and commerce since 1956 serves to disperse economic power. Consolidation is occurring in the commercial, non-financial sector and, separately, in the banking and financial sector at a rapid pace. The effects of consolidation are not well understood. Economists are beginning to study the linkages between an economy with industries dominated by a small number of mega-firms and sluggish growth in wages, inflation, and corporate investment.¹⁸

But the scale of consolidation is kept in check by the barrier between banking and commerce.



Credit allocation and market distortion

In addition to the safety and soundness concerns outlined above, consolidation of corporate-banking combinations would inhibit impartial credit allocation. An ILC subsidiary of a commercial company would not function as an independent credit provider. The commercial parent company could deter the bank subsidiary from lending to a competitor of the parent, even though the competitor may be a good loan prospect. The bank subsidiary might restrict lending to customers or suppliers of the parent or only offer favorable terms to these entities. If the competitor cannot obtain a loan on favorable terms, it might decide to acquire its own bank subsidiary to remain competitive by funding itself through FDIC-insured deposits. **Thus, competitive pressures could cause a small number of commercial parent-bank subsidiary combinations to quickly escalate, resulting in an entire commercial sector funded by FDIC-insured deposits.** Those commercial corporations that do not have the resources to charter or acquire an ILC to remain competitive, will themselves be acquired. This will promote consolidation.¹⁹

¹⁸ Irwin.

¹⁹ Wilmarth, Arthur E. "Beware the Return of the ILC." *The American Banker*. August 2, 2017. "Banking-industrial combinations would also create unfair competitive advantages for large commercial and industrial firms that can afford the costs of acquiring and operating banks. FDIC-insured deposits are the cheapest source of private-sector funding available."

If this is allowed to occur as a result of the ILC loophole, businesses that should have access to credit based on the value of their ideas and the economic promise they hold, will struggle to obtain credit. The concentration of economic power would change the character of commercial life. Something vitally important is lost when the credit function is subordinate to commercial conglomerates, what Roosevelt called the “traditional virility, independence, adaptability and daring” of American business.²⁰

Are we ready for an “Age of Mega-Conglomerates”?

In the 1950s, as previously noted, TransAmerica alarmed the American public and policymakers as an example of the unchecked power of conglomeration. Imagine a new breed of mega-conglomerates with tentacles into technology, retail sales, various business and consumer services, as well as commercial and investment banking, insurance, investment advisory and management, and more. What kind of economic and political power would such conglomerates hold over the lives of ordinary Americans? We do not have to go as far as President Franklin Roosevelt in comparing concentrated economic power to fascism to believe that such power carries the potential for grave abuse.²¹

Consumers and workers would be vulnerable to price and wage manipulation. Are our anti-trust laws robust enough to keep super-conglomerates in check? The dominance of such firms would be especially harmful for the thousands of small and rural communities which are currently served by a diversity of small businesses and community banks.

In a digital economy, the ILC charter carries new risks

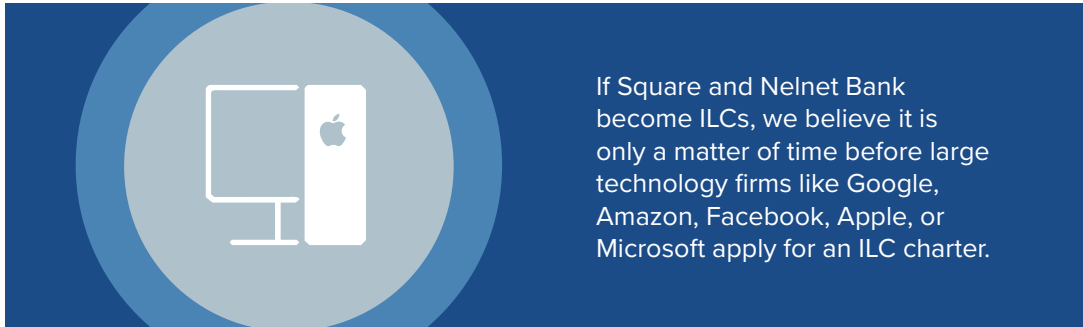
There are thousands of U.S. fintech firms deeply involved in non-financial commercial activities. Many of these would no doubt welcome the opportunity to obtain an ILC charter with deposit insurance in order to obtain low-cost deposit funding while retaining and expanding their commercial ventures.²²

The integration of these technology and banking firms would not only result in an enormous concentration of financial and technological assets but also would pose conflicts of interest and privacy concerns to our banking system.

²⁰ See supra note 4.

²¹ Roosevelt. “The first truth is that the liberty of a democracy is not safe if the people tolerate the growth of private power to a point where it becomes stronger than their democratic state itself. That, in its essence, is Fascism—ownership of Government by an individual, by a group, or by any other controlling private power.”

²² See, for example, Witkowski, Rachel. “Are Fintechs Better Off Taking the ILC Route to Banking.” *The American Banker*. January 22, 2019. “Growing uncertainty about a new federal charter offered by the Office of the Comptroller of the Currency is magnifying a different option for fintech firms seeking a way into the banking sphere: the industrial loan company.”



What will happen when social media giants extend their reach into our financial lives? Big data tracks our movements, our friends, families, and associates, our religious and political affiliations and views, our internet browsing and shopping history. This data is already used (some would say abused) for marketing products and services and for targeted political messages—sometimes by nefarious actors. Adding personal, financial data—monthly paycheck direct deposits, account balances, expense patterns, political contributions, history of late fees, transaction records, etc.—would take targeted marketing to a whole new level. Moreover, this financial data could be sold to third-party data aggregators.

An end to neutral financial product offerings?

This data could be used to discriminate in lending and other financial services. Will your credit or insurance offerings be based on your social profile? What about your lifestyle, travel, shopping habits, and friends? The opinions you post and even the opinions your friends post, parsed finely enough and filtered through an algorithm, may correlate with your credit risk or your likelihood of filing an insurance claim.

Consider the potential for price discrimination even for non-financial products. As Karen Shaw Petrou has observed: “One specific danger of a company like Amazon getting into finance is the possibility of analytics-based price manipulation. A consumer might try to buy a pair of sneakers and be offered a more expensive pair of sneakers because Amazon knows how much money he or she has... It’s watching your payment speed, estimating your pain threshold, and all of a sudden prioritizing products based on what it thinks it knows about what you can afford.”²³

We believe this would be a step well beyond the comfort zone of most Americans. Dominant social media-commercial-financial mega-firms would

²³ Shaw Petrou, Karen. “Making ‘Responsible Innovation’ a Reality: Big Tech, Small Money, and U.S. Economic Equality,” Federal Financial Analytics. February 4, 2019. See also: Smith, Noah. “Artificial Intelligence Still Isn’t All That Smart.” Bloomberg Opinion. August 16, 2018. <https://www.bloomberg.com/view/articles/2018-08-16/smart-machines-won-t-be-ready-to-do-complex-jobs-anytime-soon>. “Machine learning-enabled price discrimination might allow companies to figure out exactly how much customers are willing to pay for things and gouge them for every penny.”

have unprecedented reach into our private lives. Such a change should not be made without careful deliberation by the FDIC and by Congress.

Closing

Before we give up our last vestige of privacy and lurch into a new era of corporate saturation, let's hit the pause button and engage in an informed debate about the future economic life of our country. FDIC approval of new ILC deposit insurance applications again would undoubtedly encourage a great number of additional, commercial applicants. Such a precedent would be hard to reverse, and a slew of new commercially owned ILCs could change the financial landscape in a few short years.

Since the 1956 BHCA, Congress has consistently reaffirmed the separation of banking and commerce and the importance of holding company supervision. As described above, Congress closed the unitary thrift holding company loophole in 1999 and closed the nonbank bank loophole in 1987. Congress has only allowed exceptions that were extremely limited in scope, as was the ILC loophole when it was created. The ILC is a threat to the Bank Holding Company Act, to the safety and soundness of the U.S. financial system, and at the leading edge of an economic transformation Americans may not be ready for. Congress should now close the ILC loophole to prevent the unraveling of the BHCA. The FDIC should impose a moratorium on new ILC charters.

ABOUT

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